PHOOLINAL LINAMOR

## FM encourages start-ups with cash flow relief for employees

Now, they can take the risk of joining without having to pay taxes on Esops immediately



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or quite some time, employees of start-ups have complained about a provision in the income-tax law that caused them hardship. Stock options at the time of exercising (allotment), creating a liquidity problem for them. In Budget 2020, finance minister Nirmala Sitharaman has announced that the time when start-up employees will have to pay tax on their allotted stocks can be deferred. While their iquidity problems have been taken are of, youngsters joining start-ups eed to pay heed to the risks they run hen they participate in an employee ock option plan.

Tax liability deferred: ESOPs are currently taxed first at the time of exercise of shares. The difference between their fair market value (FMV) on the date of exercise and the exercise price is taxed as perquisite. The employer deducts tax at source. of shares. The employee's capital gain gets taxed, the amount being the difference between the sale price and the FMV (on date of exercise).

> Now, for employees of specified start-ups, the payment can be deferred. The tax can now be paid not at the time of allotment, but whenever one of three events occurs first: One, the date the employee leaves the company: two, when the share is sold: or three, after five years from the

THIS CHANGE? ■Should be an eligible

start-up according to Section 80-IAC

Should have been Incorporated after April 1, 2016 but before April 1, 2021

■Turnover should not exceed ₹100 crore

... Should hold a certificate from the Inter-Ministerial Board of Certification

financial year in which it was exercised. The tax rate that applies will be of the year in which the option was exercised.

employee only gets shares, not he cash. "Start-up employees fac hardship because while a tax liabil arose at the time of allotment shares, there was no monetary g for them to pay the tax. The propor change will help them deal with th

cash flow issues," says Shalini Jain, tax partner, people advisory services, EY India. Employees will also benefit if they have moved into a higher tax bracket. "You will pay tax at the rate that applied to you when the shares were allotted," says Homi Mistry, partner, Deloitte India.

This benefit will only be provided only to startups that meet certain criteria (see box). "Ideally, it should have been provided to a wider range of non start-ups," says Jain.

Next, let us turn to some of risks employees opting for Esops run.

Valuation risk: This is one. biggest "Employees give up on something tangible the cash component in FY In their salary - based on

the belief in their ability to contr to the company's growth story while opting for Esops, it is im ble to tell which side valuation tilt," says Winnie Shekhar, pa IndusLaw.

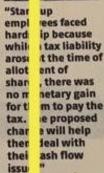
If the valuation declines bet the time of exercise and that o the employee could end up ove At the time of allotment, the ingtax. "Defer exercising your of until you are close to the sale of shares," says Rupali Singhania, Partner, Areete Consultants LLP.

Opt for Esops based on your age and risk-taking ability. "Somebody in his 20s can take greater risk than someone in 40s or 50s. Older people also have more obligations. They should opt for a bigger cash component in their salary," says Mistry.

Liquidity risks Start-ups are unlisted, so there is no ready market for their shares. Employees can only exit at the time of IPO, if the company is acquired by a new investor, or if it does a buyback.

Check the Esop agreement closely: When an acquisition take place, will employees will be treated at par with promoters? "Sometimes, pro-

> moters are able to encash their shares while employees are not given the same opportunity," says Singhania. Study the Esop plan for exit options. Some companies set up trusts to buy back shares, which provides comfort that employees will be able to sell shares in an emergency.



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Know the vesting schedule: Employees could lose their shares if they do not spend their entire vesting period (the time after which they acquire a right over the shares) with the company. Suppose that the vesting period is four years and 10 per cent of Esops vest in the first year, 20 per cent in the second, 30 per cent in the third, and 40 per cent in the fourth. The

bigger tranches vest later on. If at But employee quits early, he would for feit those shares.

Employees are given time to exer cise vested shares. "The exercise per od is shortened to 60-90 days from the date of leaving the company, employees quit. Be aware of such cor ditions or else you could lose out ons says Singhania.